

STATE OF CALIFORNIA

DEPARTMENT OF INSURANCE

In the Matter of: Proposed adoption of the Insurance Commissioner's regulations pertaining to pure premium rates for workers' compensation insurance, the Experience Rating Plan and the Uniform Statistical Reporting Plan to be effective on July 1, 2005.

FILE NUMBER RH-05-044493

DECISION

Today, we see the dramatic drop in claims costs from accident year 2004, a result of the significant reforms of the California Workers' Compensation system passed in 2003. Today, I adopt a pure premium rate reduction of 18% percent, in addition to previous rate reduction recommendations totaling 22.6 percent. Every six months since the reforms became effective, I have issued decisions, based upon actuarial analysis, that have decreased the pure premium rate, which is the cost of claims upon which insurers' rates are based. The WCIRB, the rating organization licensed by my department to analyze past trends, project future costs, and recommend the pure premium rate, has recommended reductions to the pure premium rate that have not kept pace with the actual decrease in claim costs. The reductions in the pure premium rate that I have issued in three decisions since mid-2003 have been more accurate projections of the actual results of the reforms. Moreover, going forward, the reforms from the 2004 legislation will further reduce the cost of claims. It is time for policyholders to see a concomitantly dramatic drop in the rates they are paying.

Many insurers have been slow to fully implement my recommended reductions and pass on the savings from the reforms to California employers as rapidly as possible. With this rate decision, I urge the insurers of California's employers to pass on the savings they have realized by reducing actual insurance premiums to reflect my pure premium rate decisions, by minimizing the use of multipliers to pump rates up.

Again, I must preface my decision with a review of my powers in issuing a decision regarding workers' compensation pure premium rates and its effect upon the actual pricing of workers' compensation premiums by insurers in the State of California. Insurance law requires that the designated rating organization analyze past cost trends and report to the Insurance Commissioner its advice on the pure premium rates necessary to pay for the anticipated claims that will occur in the next year or within the next six months if related to an interim rate, such as this. The commissioner is required to conduct a hearing on the proposed rate change and then render a decision on the proposal. This decision then becomes an advisory rate increase or decrease for the workers' compensation insurance industry. However, I have no ability to require insurers to increase or decrease their rates since this is only a recommendation.

In accordance with the law and considering the advice of my staff, including two senior Department actuaries, I have changed the WCIRB's proposed advisory pure premium rate reduction from a decrease of 13.8% to a decrease of 18% for workers' compensation insurance policies incepting on or after July 1, 2005. This decision, in combination with the past pure premium rate decreases, results in a total decrease of the pure premium rate of 36.5% as compared to the July 2003 rates.

This total rate decrease is supported by the unprecedented 2004 accident year loss ratio of 45%, meaning that insurers in the aggregate paid out 45 cents in losses for every dollar of premium received in calendar year 2004. Although this disparity is caused in part by the higher premium from policies that began in 2003 before the reforms, the loss ratio for accident year 2004 would have been high even calculated with a flat 2004 rate level. Moreover, the combined ratio of loss and expense to premium reported to me by insurers in their financial statements is at a record low of 72% for accident year 2004.

Insurers have been hesitant to lower premiums in lockstep with my rate decisions for many reasons. They have noted that the reforms are new and untested with the courts or that the reforms could be amended by the legislature. However, the majority of the reforms enacted in 2003, which affected the 2004 accident year, have not been challenged or amended or when challenged, have been upheld by the courts. In addition, the frequency of claims has continued to drop. Additionally, I want to assure insurers and injured workers that I am going to investigate whether faulty claims handling is playing a part in the drop in losses. But in large part, the reforms to the workers' compensation system reflected in the 2004 accident year can be counted upon to continue to produce lower claim costs in the future. The newer reforms from the 2004 legislation, such as the final effect on losses for the permanent disability changes, have provoked a range of projections and are murky at best. But insurers' rates have not factored in the full effect from the 2003 reforms. These must be passed through to policyholders.

Happily, the California workers' compensation insurance market has improved—new and existing workers' compensation insurers are taking on new business. However, the California workers' compensation marketplace continues to be dominated by State Compensation Insurance Fund (SCIF), which has over 50% of the insured market and writes essentially all of the state's small businesses. SCIF's future actions with respect to premium pricing and dealing with its financial issues are key in bringing down workers' compensation premiums for all of California's employers.

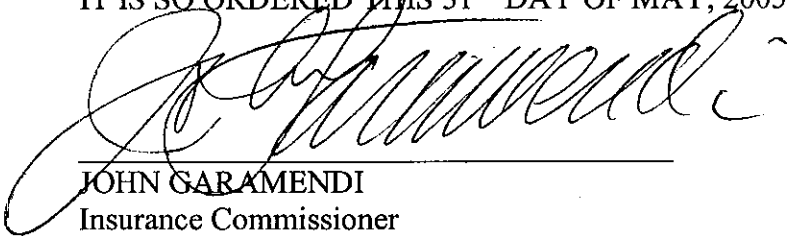
SCIF is a market leader in classic economic terms and sets the price to which other insurers gravitate. This circumstance allows other insurers to price around SCIF either to take on or avoid new business, while SCIF remains the insurer of last resort for those employers that other insurers do not wish to insure. I recognize that SCIF is attempting to address its financial challenges after absorbing extraordinary amounts of business at the end of the last decade due to insurance company insolvencies. I believe, however, that SCIF can implement strategies that permit it to provide meaningful reductions of premium while rebuilding its surplus. Such an approach would allow for immediate savings to California's employers insured by SCIF and a more competitive insurance marketplace.

It is also apparent that insurers are using multipliers to keep policyholder premium rates high. The Department of Insurance is going to take a close look at the use of these multipliers and will report on it in the near future.

Finally, I again ask the Legislature and the Governor to enact legislation to clean-up technical problems noted in the new reform laws.

I hereby adopt the attached Proposed Decision and Proposed Order of Hearing Officer Christopher A. Citko as my Decision in the above-entitled matter.

IT IS SO ORDERED THIS 31st DAY OF MAY, 2005



JOHN GARAMENDI
Insurance Commissioner